ADVANCED GCE **2888/SM**

ECONOMICS

Economics in a European Context

STIMULUS MATERIAL

JANUARY 2008

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Bulgaria and the EU: In at last

Introduction

Bulgaria and Romania's full membership of the European Union (EU) from the beginning of 2007 brings the total number of member states in the EU to 27. This follows a major enlargement in 2004.

As a former command economy, Bulgaria has undergone a transition, starting in 1990, to a market economy. Initially there was much praise for the speed and depth of that transition but it soon faltered, resulting in an economic crisis in 1997. A second phase of transition began shortly afterwards. Much more successful, this transition soon led to an improvement in the performance of the Bulgarian economy.

Despite these improvements, average per capita income in Bulgaria remains low. With its population declining significantly, particularly amongst those of working age, the Bulgarian economy will need to ensure that the productivity of labour is raised if it is to see its per capita income continue to rise. Like many new member states of the EU, Bulgaria has attracted investment from foreign owned companies. Its foreign direct investment (FDI) has been significant in terms of value and in 2005 accounted for over 9% of Bulgaria's GDP, exceeding the proportion in the Czech Republic and Hungary. There have, however, been questions raised about the extent of the benefits of such FDI.

With average per capita income in Bulgaria significantly below that in the EU15, there is a strong likelihood that Bulgarian workers will migrate to countries including Spain and the UK. Should this happen, it may further reduce the working population in Bulgaria creating problems for the economy. Fears of labour migration, though, are not just confined to the impact on the Bulgarian economy.

Despite the many challenges ahead for their economy, most Bulgarians themselves are optimistic about the impact of EU membership. Drawing on the experience of the eight former command economies admitted to the EU in 2004 (the EU8), they expect there to be significant economic benefits.

Pre-issued stimulus material

Extract 1	**The Bulgarian Economy: selected economic indicators 2000 – 2005** Europe in Figures, Eurostat Yearbook 2005 and World Bank Data Query	
Extract 2	**Bulgaria: the road to successful EU integration** Rosalinda Quintanilla et al, World Bank Report No. 34233-BG, November 2005	
Extract 3	**EU accession for Bulgaria fuels Greek bank expansion in Balkans** eubusiness.com, 11 November 2006 **FDI in Bulgaria: domestic and external impacts** Rosalinda Quintanilla et al, World Bank Report No. 34233-BG, November 2005	
Extract 4	**"Join the queue", says Spain** Economist Intelligence Unit 2 November 2006 **In praise of enlargement** The Economist print edition, 28 September 2006	
Extract 5	**Bulgaria looks to EU for economic improvements** EuroNews, The 2004 enlargement of the EU, 10 December 2006 **Enlargement, two years after – An economic evaluation** Bureau of European Policy Advisers and the Directorate-General for Economic and Financial Affairs, European Commission Occasional Paper No. 24, May 2006	

Extract 1

The Bulgarian Economy:
selected economic indicators 2000 – 2005

	2000	2001	2002	2003	2004	2005
GDP (current € bn)	13.70	15.45	16.59	17.73	19.60	21.45
Real GDP growth (annual %)	5.40	4.10	4.90	4.50	5.60	5.50
Inflation rate (annual %)	10.30	7.40	5.80	2.30	6.10	5.00
Unemployment rate (%)	16.40	19.50	18.10	13.70	12.00	10.10
Investment (current € bn)	2.15	2.78	3.03	3.43	4.08	5.10
Foreign direct investment, net inflows (current € bn)	1.09	0.92	0.96	1.86	1.62	n/a

Extract 2

Bulgaria: the road to successful EU integration

Over the last seven years, Bulgaria has made impressive progress towards long-term stability and sustained growth. However, both Bulgaria and Romania are significantly poorer than the EU8 (see Fig. 2.1). To narrow the income gap and facilitate convergence with the rest of the EU, Bulgaria needs to increase employment and productivity. Raising investment and productivity are necessary for long-term economic growth. This is particularly critical given the long-term population projections for the country as shown in Fig. 2.2. As Bulgaria approaches EU accession, it has the opportunity to act on these challenges and set the economy on a higher growth path. To be effective, Bulgaria must enact several structural reforms in a stable macroeconomic environment, including improving human and physical capital, better public sector management and stronger labour market performance.

Fig. 2.1 A comparison of per capita income as a % of the EU25 average, in ten EU countries

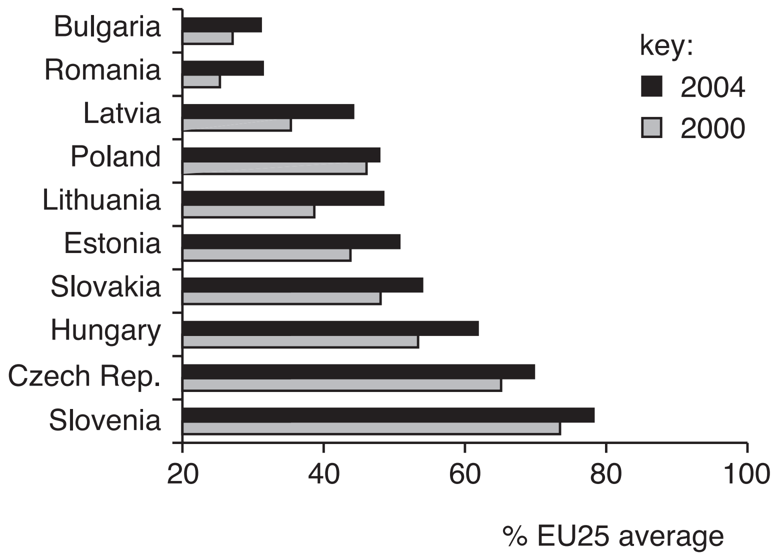
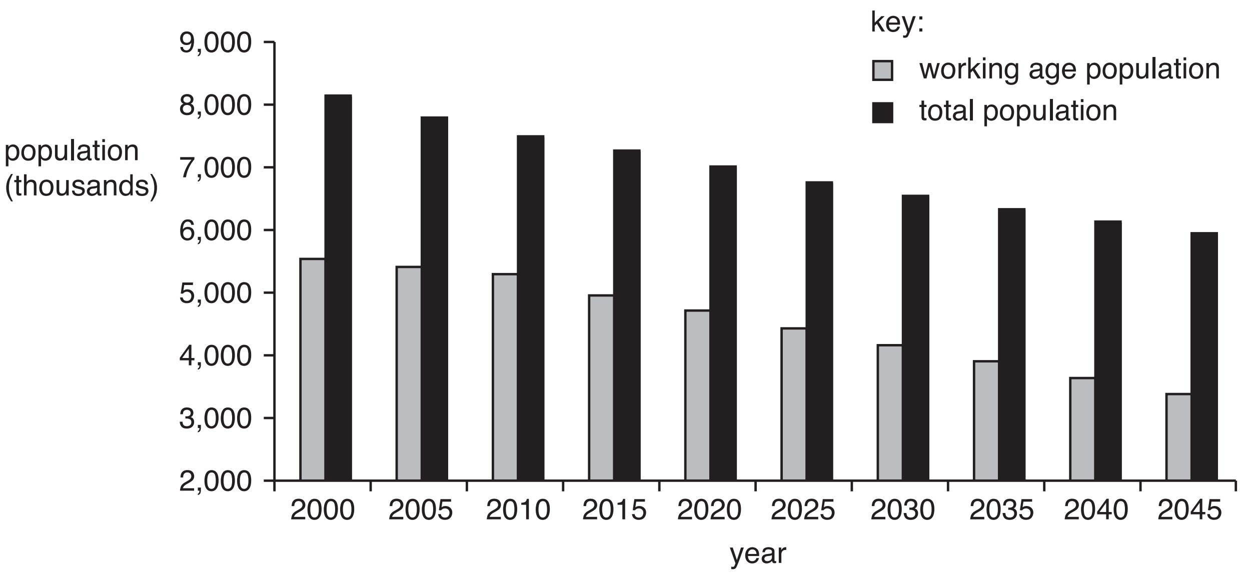


Fig. 2.2 Population projections (thousands) for Bulgaria



Extract 3

EU accession for Bulgaria fuels Greek bank expansion in Balkans

Taking advantage of their geographical proximity and knowledge of the region, Greek banks have found a fertile backyard for expansion in the Balkans over the past decade. This trend is likely to intensify with EU entry for Bulgaria and Romania.

In 2005, Greek banks had 18 subsidiaries in the region and a network of branches employing some 15,000 people, a threefold increase from the start of the decade. More than 1,200 Balkan bank branches are in Greek hands, constituting a market share of over 20 per cent.

"The economies of Bulgaria, Romania, Serbia and Turkey are growing rapidly, but bank markets there are still weak," says Vassilis Panayiotidis, a senior economist at the Union of Greek Banks.

Overall, Greeks have invested 14 billion euros in Balkan countries in fields including telecommunications, the food and cement industries and financial services.

FDI in Bulgaria: domestic and external impacts

The private sector in Bulgaria is characterised by a relatively small number of large firms, some of which are foreign owned. These are growing rapidly and generating high levels of productivity but are fairly isolated from small and medium enterprises which exhibit large inefficiencies. At the firm level, foreign direct investment (FDI) flows are positively associated with higher productivity. However, on average from 1998 – 2003, about 60 per cent of FDI in Bulgaria was located in services, with more than half of this FDI in the financial sector. Only about 30% of the FDI in Bulgaria currently generates output which is traded with other countries. What is exported by foreign multinationals at present is dominated by unskilled labour-intensive products.

Extract 4

"Join the queue", says Spain

On 31 October, Miguel Angel Moratinos, Spain's foreign minister, announced that the country will impose a two-year restriction on Bulgarians and Romanians looking to work in the country when the two states join the EU in January 2007. The same transition period was introduced for the eight new member states from Central and Eastern Europe which joined in May 2004. The statement comes shortly after a decision by the UK government earlier in October to prevent all but a few highly-skilled or seasonal agricultural workers from taking jobs in Britain, and is in line with similar policies across the rest of the EU. The announcement has created indignation among Bulgarians and Romanians. But is the cautious approach the right one?

Given the underestimation by the UK authorities of the numbers of post-accession arrivals into Britain, a similar influx into Spain would be highly likely. Few believe Bulgaria's labour minister, who recently claimed that only around 1% of the working population would seek jobs abroad. Wages in Bulgaria and Romania are roughly one-third of those in Central and Eastern Europe, which in turn are around one-third of those in Western Europe. So the incentives for the newest EU members to move west for work are powerful.

Spain's trade unions have added their voices to the new sense of cautiousness, arguing that immigration would crowd out locals from jobs, while encouraging unscrupulous employers to squeeze wages.

In praise of enlargement

There is no clear answer to the question of how far east Europe stretches. But Bulgaria and Romania are European by any definition. So this week's news that these two Balkan countries are to join the European Union next January ought to be welcomed. Yet it was greeted with dismay in some European capitals. Many EU countries fear the consequences of labour migration from Bulgaria and Romania.

The most recent expansion, the big bang of May 2004, when eight former command economies (plus Cyprus and Malta) joined, has been highly successful. The growth in size of the EU has brought stability and prosperity to new members – and yielded tangible benefits for existing ones.

Labour migration, contrary to some fears, has also been beneficial. A European Commission Report showed that the three countries (Britain, Ireland and Sweden) that let in workers, without restriction from the east in 2004, all gained. Labour mobility is not a zero-sum game: both senders and recipients win. Better to welcome the new workers now, rather than imposing restrictions which most EU members (even Britain) are planning in a bid to appease the populist press.

Extract 5

Bulgaria looks to EU for economic improvements

Along with its neighbour, Romania, Bulgaria signed the European Union Accession Treaty in April 2005, paving the way for the country to join the bloc in 2007.

Bulgaria missed the 2004 EU expansion round because it was deemed to have failed to implement sufficient market reforms. However, the population remains more pro-EU than in many member states.

There are numerous reasons for Bulgaria's enthusiasm about EU membership, says Ivan Krastev, the head of the Centre for Liberal Studies in Sofia. Two-thirds of Bulgarians surveyed said they expected EU membership to improve their economic prosperity.

Ivan Krastev explains: "Bulgaria is a small country. In this big, global world, the EU is perceived as an instrument for globalisation, but also as a protection against excessive globalisation, so people expect better incomes."

Enlargement, two years after – An economic evaluation

The biggest enlargement ever of the EU is an economic success. Two years after the May 2004 enlargement, the European Commission issued an economic evaluation, reviewing the experience and drawing lessons which could be useful for future enlargements.

The economic implications of this enlargement were reviewed extensively before it happened. Studies ahead of accession predicted a significant boost of economic growth for the new member states (1.3–2.1% additional GDP growth per year).

The favourable economic expectations have been fulfilled. The new member states have undertaken extensive reforms to modernise and are now dynamic market economies. The stability provided by accession has helped to increase trade and investment between the EU15 and the EU10 as well as within the EU10, creating a win-win situation for all involved:

- contributing to growth and employment in the EU;
- opening new opportunities for firms in the EU;
- helping EU firms stay competitive in the face of an ever more challenging global environment;
- benefiting EU consumers.

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